No. 88-940

Supreme Court, U.S.
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In The Supreme Court of the United States October Term, 1988

BANK ONE, STEVENS POINT, NA,

Petitioner,

v.

UNITED STATES DEPARTMENT OF COMMERCE, ECONOMIC DEVELOPMENT ADMINISTRATION, C. WILLIAM VERITY in his official capacity as Secretary of Commerce, UNITED STATES OF AMERICA, REMER HUTCHINSON, and ELAINE HUTCHINSON,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTIONS PRESENTED

1. May the federal government escape liability on its guarantees to a lender pursuant to a federally-guaranteed high-risk loan program where the federal officials authorized to administer the federal guaranty program knew of, participated in and approved the very practices and decisions upon which the federal government now relies to renege on its guaranty obligations?
2. May a court of appeals make findings of fact?
3. Did the court of appeals properly apply the doctrine of pendent-party jurisdiction when it vacated a final, litigated judgment and ordered the pendent parties dismissed, even though the claim related to them arose out of the same financial transaction and the requirements of the same government loan program as the claim related to the federal government?

LIST OF PARTIES

The parties to the proceedings below include the petitioner Citizens Marine National Bank*- and the respondents United States Department of Commerce, Economic Development Administration, C. William Verity, in his official capacity as Secretary of Commerce, United States of America, Remer Hutchinson and Elaine Hutchinson.

Other parties involved below include Weber Tackle Company and Weber Plastics, Inc. These parties stipulated to a judgment of foreclosure and replevin in favor of the petitioner before trial, were not involved in the appeal to the Seventh Circuit, and are not before this Court.

- *Petitioner Citizens Marine National Bank has changed its name since the inception of this litigation and is now known as BANK ONE, STEVENS POINT, NA. Petitioner's parent company during this litigation became The Marine Corporation. The Marine Corporation has since been acquired by BANC ONE CORPORATION.

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In The
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CITIZENS MARINE NATIONAL BANK, formerly the Citizens National Bank of Stevens Point,

Petitioner,

v.

UNITED STATES DEPARTMENT OF COMMERCE, ECONOMIC DEVELOPMENT ADMINISTRATION, C. WILLIAM VERITY in his official capacity as Secretary of Commerce, UNITED STATES OF AMERICA, REMER HUTCHINSON, and ELAINE HUTCHINSON,

Respondents.

Petitioner, Citizens Marine National Bank, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit entered in this case on August 8, 1988.

OPINIONS BELOW

The memorandum decision of the United States District Court for the Western District of Wisconsin (Shabaz, D.J.) has not been reported. It is printed in the appendix at A.13.[1] The district court's opinion expressly incorporated the parties' stipulated findings of fact which are also included in the appendix, A.21. The district court's

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[1] Citations to "A." are to the Appendix accompanying this petition. Citations to "Ex." are to the trial exhibits and "R." to the docket sheet entries of record.

memorandum and order granting the motion for summary judgment of Citizens Marine National Bank against Remer and Elaine Hutchinson is not reported and is printed in the appendix, A.61. The opinion of the United States Court of Appeals for the Seventh Circuit is reported at 854 F.2d 223, and is printed in the appendix, A.1.

JURISDICTION

The jurisdiction of the United States District Court for the Western District of Wisconsin was invoked under 19 U.S.C. § 2350 because this case involves a controversy arising from the government's provision of financial assistance under the Trade Act of 1974, 19 U.S.C. § 2341 *et seq.* The final judgment of the district court was entered on October 8, 1987. A.70. The judgment of the United States Court of Appeals for the Seventh Circuit was entered on August 8, 1988. A timely petition for rehearing with suggestion for rehearing *in banc* was denied on September 9, 1988. A.75. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The following provisions of the Trade Act of 1974 are set forth in full in the appendix, A.76-78:

1) 19 U.S.C. § 2342(b) (1982) Approval of Adjustment Proposals: Technical and Financial Assistance;

2) 19 U.S.C. § 2344(a) (1982) Financial Assistance: Direct Loans and Guarantees of Loans;

3) 19 U.S.C. § 2345(a) and (e) (1982) Conditions for Financial Assistance: Unavailability of Firm's Resources; Reasonable Assurance of Repayment and Loan Guarantee Conditions;

4) 19 U.S.C. § 2347(a)(5) (1982) Administration of Financial Assistance: Powers of Secretary;

5) 19 U.S.C. § 2350 (1982) Civil Actions.

STATEMENT

In 1981 petitioner, Citizens Marine National Bank ("Citizens"), a small, independent community bank in central Wisconsin, was induced to make two loans, totalling $2.1 million, to Weber Tackle Company and Weber Plastics, Inc. ("Weber"), by the federal government's promise to guarantee 90% of those loans pursuant to the Trade Act of 1974 ("Trade Act"), 19 U.S.C. 2341 *et seq.* Exs. 2-5. Weber was a distressed fishing tackle manufacturer and significant employer located in central Wisconsin. Ex. 1. When Weber was unable to repay the loans, Citizens turned to the government as guarantor. The government refused to honor its guarantees, resulting in this litigation.

A. The Federal Guaranty Program Pursuant To The Trade Act Of 1974.

Under the Trade Act, the Secretary of Commerce was authorized, through the Economic Development Administration ("EDA"), to make and guarantee high-risk loans, that financial institutions would not otherwise make, to businesses severely and adversely affected by imports.

In order to obtain Trade Adjustment Assistance, an affected business was required to provide a "reasonable assurance of repayment" of the loan. 19 U.S.C. § 2345 (a) (2) (1982); 13 C.F.R. § 315.56 (a) (3) (1988); A.52. The Senate report accompanying the bill recognized, however,

> that the adjustment assistance loan program will deal with firms that have been weakened by import competition. In this regard the *term 'reasonable assurance of repayment,' which refers to both direct and guaranteed loans, should not be taken to mean reasonable assurance of repayment in the strict banking or commercial sense because adjustment assistance loans are admittedly high risk loans.*

S. Rep. No. 1298, 93rd Cong., 2d Sess. 149 (1974) (emphasis added). As in other federal high-risk credit programs, the

EDA was considered "the bank of last resort." R.196. In order to receive a federal guaranty under the Trade Act, a company was required to demonstrate that it could not get financial assistance from *any* private bank or financial institution *without* the federal guaranty.[2]

B. The Guarantees to Citizens.

During 1979, Weber approached Citizens and requested working capital and fixed asset loans for use in financing Weber's operations and for modernization. Citizens, as well as other area banks, determined that they would not lend Weber the requested funds because of Weber's unsatisfactory credit history and large debt. A.23. Weber then commenced the certification and application process for federal assistance under the Trade Act. A.23-24. From that moment on, the EDA controlled and actively participated in Weber's Trade Adjustment Assistance transaction.[3]

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[2] Approximately 77% of those companies that actually received federal assistance under the Trade Adjustment Assistance program failed to recover. *See* U.S. Dept. of Commerce, Office of Inspector General, Rep. No. D-068-5-006, *International Trade Administration Trade Adjustment Assistance: No Cure For Import-Injured Firms,* (March 1985). A House committee concluded that the program had "been administered arbitrarily over the years, creating uncertainty and unfairness." H.R. Rep. No. 241, 99th Cong., 1st Sess. 190 (1985).

[3] The EDA exercised significant control over and maintained active participation in the servicing and monitoring of the entire Weber transaction in, among other things, the following respects:

-It controlled Weber's application for federal assistance (A.23-31; Exs. 1, 29-36, 44-52, 72-77);
-commissioned business and financial experts to prepare a "Recovery Plan" for Weber (A.24-28);
-independently reviewed and determined that Weber's Recovery Plan was viable and acceptable (A.27-29);
-attended and controlled the closing (A.32);

Continued

The EDA, and not Citizens, commissioned financial experts, at the government's expense, to develop a "Diagnostic Analysis and Recovery Plan" ("Recovery Plan") for Weber as required under the Trade Act.[4] The EDA's Acting Deputy Assistant Secretary for Finance wrote to its Regional Director that the EDA was aware of Weber's "precarious" financial position and that Weber was in desperate need of a "miraculous recovery." Ex. 37. Nevertheless, the EDA determined the proposed final Recovery

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[3] *Continued from previous page*

-authorized initial disbursements to Weber (A.32);
-required and approved the procedures for the disbursement of the loan proceeds (A.33-34; R. 228: 42-53, 98; Ex. 76);
-imposed numerous reporting and other requirements on Citizens and Weber (A.32, 35-37; Exs. 2-5, 10-16, 73, 76, 77, 81-86, 92, 111-117, 119-139, 154, 156-160, 168, 170-172, 178, 179, 181-189);
-denied a merger of Weber with another company (Exs. 82-83);
-denied a modification request to shift unneeded fixed asset funds to working capital (A.38; Ex. 118);
-denied a modification request to amend allowable fixed asset uses in accordance with Weber's changing needs (A.38-40; Ex. 95);
-considered options to enable Weber to work its way out of default (A.37-40);
-performed an updated analysis of Weber's Recovery Plan and determined that the Recovery Plan remained viable even after Weber's default (Ex. 94); and
-authorized Citizens to accelerate the loan and to make demand on the guarantors. (Ex. 162).

[4] The proposed final Recovery Plan was submitted to the EDA by Weber and the Midwest Trade Adjustment Assistance Center, a federally sponsored entity comprised of business and financial experts. Ex. 1. The EDA reviewed the Recovery Plan to ensure that it contained all the information the EDA needed in order to evaluate Weber's application, including but not limited to. the required findings set forth in the Trade Act. A.27-28, 49-60.

Plan was viable and acceptable after an independent EDA review prior to closing. A.24-29; Ex. 1.[5]

The EDA then offered to enter into Trade Adjustment Assistance loan guarantees with Citizens in order to induce Citizens to make the loans to Weber. R. 74, 107, 182. As a necessary component of the transaction, the EDA required that the Small Business Administration ("SBA") subordinate its interest in certain of Weber's collateral to the EDA. This collateral secured an existing SBA guaranty made pursuant to the SBA loan program. The EDA further required that Citizens obtain a personal guaranty from Remer and Elaine Hutchinson, who were the owners and principal officers of Weber. Exs. 2-5.

Prior to closing, the EDA received all of the information it had requested from Citizens, *including* Weber's audited financial statements for the fiscal year ending July 31, 1981.[6] A.87; Ex. 51. The 1981 financial statements showed that Weber was behind in the financial projections

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[5] The EDA also performed a specific analysis to determine whether Citizens would be in a better, or more secure position after the Trade Adjustment Assistance guaranteed loans were made, than before. R. 188:5; Exs. 37, 50. The EDA determined that Citizens was less, or equally, secured after the federal loan guarantees were issued as compared to Citizens' pre-guaranty position. This finding was required prior to EDA's approval of the guarantees. Ex. 37; R. 188.

[6] The EDA did not express any criticism concerning Weber's 1981 financial statements or the closing of the loans in any of its pleadings before the district court and never expressed any concern about the financial statements or the closing until the time of trial. The district court did not specifically determine that the EDA had obtained Weber's 1981 financial statements prior to closing. However, the stipulated exhibits show that the EDA had received the statements prior to closing (A.87, 88; Exs. 51, 68), and the EDA acknowledged on appeal that it had done so, as the court of appeals recognized. A.10.

contained in the Recovery Plan.[7] The accounting firm responsible for preparing Weber's 1981 financial statements *wrote directly to the EDA* and specifically drew attention to Weber's continuing financial troubles:

> Although the statements were prepared in conformity with generally accepted accounting principles, we were required to qualify our opinion because of the uncertainty of the Company's ability to increase its sales volume in accordance with its recovery plan, which the company must do to remain a viable entity.

A.88; Ex.68.

Under the guaranty program, the government, and not Citizens, was responsible for determining whether the loans would be closed and the guarantees made. Exs. 2-5, 14, 76, 109. On December 17, 1981, the loans were closed and the guaranty agreements became effective. A.32, 90; Ex.14. An EDA financial analyst and loan officer, together with EDA's legal counsel, were present at the closing. A.32. They verified that all of the requirements on EDA's extensive closing checklist were met. Ex. 76.

The guaranty agreements expressly provided that Citizens "shall not make first disbursement" on the loans until the Regional Director of the EDA provided written notice that, "in the opinion of the Regional Director," there had been no unremedied adverse changes in the financial condition of Weber sufficiently serious to warrant withholding disbursements. Exs. 3, 5. Immediately following the closing, the Regional Director of the EDA, with specific delegation of authority from the Assistant Secretary of Commerce (A.82; Ex. 7), confirmed in writing that all program requirements for closing had been accomplished

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[7] Weber had fallen behind the Recovery Plan financial projections due in part to the long certification and application process required for obtaining Trade Adjustment Assistance.

and *authorized* Citizens to disburse proceeds. The Regional Director also *certified* that as of December 17, 1981, seven days after the EDA had received Weber's 1981 financial statements and after the EDA had received direct communication from Weber's accounting firm, there had been no unremedied adverse change in the financial condition of Weber sufficiently serious to warrant withholding disbursements on the loans. A.82, 88, 90; Exs. 7, 14, 68. Citizens then disbursed the funds.[8]

Throughout the process, the EDA specifically instructed Citizens to deal directly with certain EDA officials for the purposes of sharing information, resolving questions as they arose and obtaining required approvals and recommendations. A.85; Exs. 9, 73, 83, 86, 98, 110, 118, 161. Citizens and EDA officials were in continuous contact both before and after the closing of the Weber loans and guaranty agreements.[9] A.35. At all times, the EDA knew of Weber's financial condition and maintained an ongoing awareness of Citizens' actions.

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[8] The guaranty agreements required Citizens to disburse, service, collect and liquidate the loans as a prudent lender would in dealing with a loan of its funds without a guaranty. This obligation, however, related only to Citizens' actions *subsequent* to closing and *subsequent* to initial disbursements of the loans. Ex. 3, 5.

[9] Citizens received and sent to the EDA monthly financial statements from Weber from 1981 through the time Weber ceased operations, as well as annual audited statements prepared by accounting firms retained by Weber. A.35-36. The EDA financial analysts then reviewed them for compliance with the guaranty agreements. A.36. Citizens also provided the EDA with the required EDA quarterly report identified as "ED-700" forms. These reports provided the EDA with information regarding the status of the Weber loans, including the amount of advances made for each loan during the prior quarter. A.36. In addition, Citizens sent to the EDA periodic financial reports and projections on Weber's operations. R. 228.

C. Weber's Default and the EDA's, SBA's and Citizens' Joint Efforts at Work-Out.

Weber defaulted on the EDA guaranteed loans on October 18, 1982. A.36. After default, Citizens continuously communicated with the EDA regarding the status of the transaction, including Weber's default, loan advances considered appropriate after default and Weber's unremedied violation of certain negative convenants contained in the loan agreements. A.36-38. In reliance on the government's guarantees, Citizens refrained from proceeding to immediately liquidate the Weber collateral but rather followed instructions from EDA officials in Washington D.C. and Chicago to continue to work with Weber and the EDA in efforts to rehabilitate Weber and maintain employment in the community. A.42-43.

In September, 1983, nearly a year after Weber's default, the EDA performed an updated analysis of the financial position of Weber, as well as an evaluation of the prospects for improvement in Weber's financial condition. An EDA financial analyst made a field visit to Weber and submitted a report of his findings. Ex. 94. This report concluded:

> [S]ince the Recovery Plan was prepared in 1979 and 1980, Weber's needs have changed. *The overall project has not changed and the Recovery Plan is still valid.* . . . A field visit was conducted with the Lender and Weber on September 8, 1983. It was *confirmed that the Lender is closely monitoring Weber's operations and is servicing the loan as a prudent lender.*

Ex. 94. (emphasis added). All circumstances about which the EDA would subsequently complain, existed and were known by the EDA prior to this visit and report.

On June 15, 1984, Citizens finally requested that the EDA honor its guaranty commitments and repurchase the 90% guaranteed portion of the loans. A.41. Citizens also demanded that the SBA honor its guaranty obligations

to Citizens on the previous SBA-guaranteed loan to Weber made under similar conditions. Ex. 149.

The SBA promptly honored its guaranty. R. 200; Ex. 152. On February 21, 1985, the EDA Director of Liquidation in Washington D.C. wrote Citizens to schedule a closing for EDA's payment on its guarantees. A.91; Ex. 193. Then, a year later, the EDA for the first time refused to acknowledge liability on its guaranty agreements by a letter dated February 20, 1986, offering no explanation except that the "EDA has determined that the Bank has not complied with all of the provisions" of the guaranty agreements. Ex. 197.

D. Proceedings Below.

Citizens had filed a state court action against Weber on June 12, 1985, prior to the EDA's refusal to pay on its guarantees, seeking to foreclose on Weber's collateral securing the Trade Adjustment Assistance loans. After Weber asserted a third-party complaint against the SBA and the EDA, the government removed the case to the United States District Court for the Western District of Wisconsin. Citizens thereafter amended the complaint to add claims against the government based upon the EDA's announced dishonor of its guaranty obligations to Citizens.[10]

The jurisdiction of the district court over Citizens' claims against the government was premised upon 19 U.S.C. § 2350, which waives sovereign immunity and empowers the Secretary of Commerce to sue or be sued, for any amount of money, with respect to claims arising from the Trade Act. A.78. Citizens also asserted a claim against Remer and Elaine Hutchinson based upon their personal guaranty. The Hutchinsons asserted a claim

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[10] Weber's third-party complaint against the government was dismissed and, ultimately, Citizens and Weber entered into a stipulation for entry of a judgment of foreclosure and replevin against Weber. R. 137, 154, 164, 292.

against both the government and Citizens relating to the EDA's interest in the collateral arising out of the guaranty loan transactions.

The government answered Citizens' complaint alleging a laundry list of facts and defenses, most of which were later abandoned or stipulated away as a result of Citizens' discovery efforts. The government specifically alleged that Citizens acted imprudently, and without the EDA's knowledge or awareness, in its disbursement procedures for the fixed asset loan, in making fixed asset disbursements after Weber's default, and in covering certain of Weber's overdrafts. R. 34, 36, 46. The government ultimately relied at trial solely upon its allegation that Citizens had failed to act as a reasonable and prudent commercial lender would act in dealing with a non-guaranteed loan. It argued, though primarily on appeal, that closing the Trade Adjustment Assistance loans after receipt of Weber's 1981 financial statements was the most significant and serious reason for releasing the government on its guaranty obligations to Citizens.

1. The District Court's Findings.

The essential facts were stipulated and adopted by the district court. A.21-60. The stipulations confirmed in detail the decisions made by the EDA and the EDA's knowledge of the actions taken by Weber and Citizens concerning the transaction.

The district court determined that the government's allegations of Citizens' imprudent practices did not release the government from its guaranty obligations because: (1) the federal program requires "imprudent," high-risk loans, as the government was fully aware (R. 235); (2) the government had proceeded with complete and ongoing knowledge and awareness of the very circumstances, actions and practices it was attempting to rely upon to avoid its guaranty obligations; and (3) neither the government nor its federal assistance program had been harmed

by any of Citizens' actions. A.17-20. The district court found that Citizens

> was indeed administering [the loans] with the approval and with the understanding of the EDA, who is now attempting to renege on its commitment.

R.235.

The district court also specifically found: (1) that the EDA had condoned Citizens' loan disbursement procedures; (2) that the EDA knew of the post-default disbursements and did not complain or protest; and (3) that the EDA had presented no evidence of harm resulting from its other allegations of imprudence. A.17-20. The district court concluded that the totality of these circumstances showed that "there has been no substantial and material breach of duty by" Citizens, and that the "government cannot now be heard to complain when it has only itself to blame for the losses which have occurred." A.20.

The district court also granted Citizens' motion for summary judgment against the Hutchinsons on their personal guaranty and granted the government's and Citizens' motions for summary judgment against the Hutchinsons on the Hutchinsons' claims concerning the collateral. A.61.

2. The Court of Appeals' Reversal.

On the government's appeal, the United States Court of Appeals for the Seventh Circuit, in a decision authored by Judge Posner, reversed the district court. The panel swept aside as "clearly erroneous" the district court's factual determination that no material breach by Citizens of its guaranty obligations had occurred, after passing quickly over this "vital question." A.9. The panel then proceeded to announce its own findings of fact.

The court of appeals found that the Trade Adjustment Assistance transaction had become "too risky" before the closing in light of Weber's 1981 financial statements. A.9.

The panel stated that Citizens' practices after closing "were less important," but that the "cumulative picture" was one of material breach, voiding the guaranty. A.10. The court of appeals also found, by jettisoning the district court's findings and creating its own, that the EDA officials did not have actual or apparent authority to bind the government, and further that the traditional elements of estoppel were not present because, it said, "there were no promises, misrepresentations, or misleading silences, and there was no reliance by the bank." A.11.

The court of appeals reversed the district court despite acknowledging that

> [t]he government had received a copy of Weber's 1981 financial statement before the loan closed, and could have withdrawn from the deal, but didn't. And the employees of the Economic Development Administration who supervised the transaction with the bank became aware of many of the bank's imprudent practices yet turned a blind eye. . . . The Trade Act of 1974 authorizes the government to make risky loans (or loan guarantees)–indeed, *requires* that they be risky, since a condition precedent is that the borrower be unable to obtain financing on ordinary terms in the private capital markets.

A.10-11 (emphasis in original).

The appellate panel also vacated *sua sponte* Citizens' judgment against the Hutchinsons on grounds that the district court lacked pendent-party jurisdiction over the Hutchinsons, a doctrine as to which it said "no generalization is possible." A.6-7, 11, 73.

Citizens timely petitioned for a rehearing with suggestion for rehearing *in banc* on August 22, 1988, which was denied by order dated September 9, 1988. A.75.

REASONS FOR GRANTING THE WRIT

This Court should review whether the federal government can escape liability on its guarantees pursuant to high-risk federal loan programs despite federal officials' actions, knowledge and decisions, for the following reasons.

First, this case presents a recurrent and fundamental question that this Court has expressly left undecided in past decisions, and as to which the circuits have applied different standards. This Court has never clarified the parameters of the federal government's responsibility and liability for the actions and knowledge of federal officials in their direct and authorized capacity as financial intermediaries with private citizens. As acknowledged by the court of appeals "[t]he question whether and in what circumstances the federal government can be estopped by an act of its agents remains unsettled. . . ." A.11. Participants in federal credit programs need guidance.

Second, this issue is of enormous import because of the large number and amount of financial transactions entered into pursuant to federal credit programs. Federal credit programs collectively make the federal government the largest financial intermediary in the nation, and directly or indirectly influence the allocation of $1.3 trillion of outstanding credit to farmers, homeowners, businesses, exporters, utilities, ship builders, and state, local and foreign governments.[11] These federal credit programs offer credit to borrowers for whom no private source of credit is

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[11] *See* U.S. Office of Management and Budget, *Special Analyses: Budget of the United States Government, Fiscal Year 1989; Special Analysis F: Federal Credit Programs,* F-1-F-94, (1988).

available, making the government the "bank of last resort" for such borrowers.[12]

The court of appeals' decision jeopardizes the integrity and undermines the continued functioning of all federal loan guaranty programs. During the pendency of this litigation, a number of other cases involving EDA guaranteed loans have been winding their way through the courts around the country, and we have been informed by counsel in at least one of those cases that EDA officials are thrusting the court of appeals' decision in the faces of financial institutions. Under the doctrine of this case, no financial institution will feel safe to enter into loans under these guaranty programs, and consequently the programs themselves will fail. While the Seventh Circuit might very well consider such a result sound economics, it is contrary to the determinations made by Congress, the branch of government entrusted with those judgments.

Third, the court of appeals' decision is in direct conflict with at least two significant principles declared by this Court: (1) When Congress places a government agency into the commercial world by virtue of, *inter alia,* waiving sovereign immunity and permitting the agency to sue or be sued, there is a presumption that the agency's liability is the same as that of any other business, *Loeffler v. Frank*, 108 S. Ct. 1965 (1988); *Franchise Tax Board v. United States Postal Service,* 467 U.S. 512, 520 (1984); and (2) Members of the public have a legitimate expectation of some minimum standard of decency, honor, and reliability in their dealings with their government. *Heckler v. Commun-*

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[12] *Id.* There are over 30 specific federal direct loan programs, and more than 20 guaranteed loan programs. A listing of these programs is set forth in the appendix at A.79. Although the federal agency involved here has had its responsibilities for the Trade Adjustment Assistance program reduced, the question presented has ongoing and recurring significance because it involves the extent to which borrowers and private lenders can have trust and confidence in the representations and actions of the federal officials with whom they are instructed to work in connection with federal credit programs.

ity Health Services of Crawford County, Inc., 467 U.S. 51, 60-61 (1984).

The fundamental unfairness of the decision below is reflected in the Catch-22 it creates: under a program like the one here, the government will induce a lender to make a loan only if the lender first refuses to make the loan without the government guaranty because of the loan's high risk; yet the government need not honor the guaranty in the event of default because of the same high risk that only the government would accept and approve in the first place. The result here is to shift to a bank in central Wisconsin a loss of $3.2 million under a government program whose predictable costs the government now wants to walk away from.

Finally, the court of appeals engaged in unauthorized fact-finding contrary to Federal Rules of Civil Procedure 52(a) and in direct conflict with this Court's decision in *Icicle Seafoods, Inc. v. Worthington*, 475 U.S. 709 (1986). The Seventh Circuit here violated this Court's clear holding that although a court of appeals may set aside fact-finding as clearly erroneous, it has no authority to make substitute fact-finding of its own.

In addition, the Seventh Circuit's *sua sponte* pendent jurisdiction ruling also presents an important question that warrants this Court's review because: (1) it involves the same important interests and policies recognized by this Court when it recently granted the petition for writ of certiorari in *Finley v. United States*, No. 87-1973; (2) it creates a direct conflict with decisions of this Court regarding the standards for the exercise of pendent jurisdiction; and (3) it undermines the Congressional determination to provide a federal forum for the parties involved in, and claims arising out of, the EDA guaranty program.

I. THIS COURT HAS EXPRESSLY LEFT UNDECIDED THE QUESTION OF GOVERNMENTAL RESPONSIBILITY FOR THE ACTIONS OF AUTHORIZED GOVERNMENT OFFICIALS, CAUSING THE CIRCUITS TO APPLY DIFFERENT STANDARDS AND REACH INCONSISTENT RESULTS.

The question of when the federal government may avoid responsibility for the actions and knowledge of federal officials has been expressly left open by this Court and has received inconsistent treatment from the circuits. *Heckler v. Community Health Services of Crawford County, Inc.*, 467 U.S. at 60 ("[w]e have left the issue open in the past, and do so again today"); *Schweiker v. Hansen*, 450 U.S. 785, 788-89 n.4, 791-92 (1981) ("[t]his Court has never decided what type of conduct by a Government employee will estop the Government . . .," [and as noted by Justice Marshall in dissent] "the lower courts are left guessing . . . ."). The justification for limiting the situations where estoppel would be permitted against the government was set forth by this Court in *Heckler v. Community Health Services:*

> When the Government is unable to enforce the law because the conduct of its agents has given rise to an estoppel, the interest of the citizenry as a whole in obedience to the rule of law is undermined . . . [W]e are hesitant, . . . to say that there are *no cases* in which the public interest in ensuring that the Government can enforce the law free from estoppel might be outweighed by the countervailing interest of citizens in some minimum standard of decency, honor, and reliability in their dealings with their Government.

467 U.S. at 60; *see also Wilber National Bank v. United States*, 294 U.S. 120, 123-24 (1935); *Schweiker v. Hansen*, 450 U.S. at 795 (Marshall J., dissenting).

In this case not only the interest of the public, but express Congressional waiver of immunity, outweighs any consideration for "immunizing" the government from liability. It is not a case where estoppel would prevent enforcement of the law. On the contrary, Citizens dealt with the government over a period of years in a private, proprietary transaction pursuant to which the government exercised significant control, just as the statute intended. Nor is this a situation where a private citizen is presumed or expected to "know" what the statutes and regulations require because there are no regulations or guidelines for private lenders, other than the representations of the agency, which define or explain the boundaries of the government's idea of prudence and risk in the unique context of this type of federal credit program.

These circumstances distinguish the holdings in the "government estoppel" cases previously considered by this Court. *See, e.g. Heckler v. Community Health Services,* 467 U.S. at 60 (1984) ("[w]hen the Government is unable to enforce the law . . ."); *Schweiker v. Hansen,* 467 U.S. at 788 ("what type of conduct . . . will estop the Government from insisting upon compliance with valid regulations . . ."); *INS v. Hibi,* 414 U.S. 5 (1973) (enforcement of immigration laws); *Federal Crop Insurance Corp. v. Merrill,* 332 U.S. 380, 385 (1947) ("[t]he Wheat Crop Insurance Regulations were binding on all who sought to come within the Federal Crop Insurance Act, regardless of actual knowledge of what is in the Regulations. . ."); *Wilber National Bank,* 294 U.S. at 123, quoting the Circuit Court of Appeals, 69 F.2d 526, 527 (2d Cir. 1934) ("[t]he law does not permit waiving statutory requirements by the acts of employees of the government."); and *Utah Power & Light Co. v. United States,* 243 U.S. 389, 409 (1917) (United States not estopped "to do or cause to be done what the law does not sanction or permit.").

Further, the decision of the court of appeals is contrary to a significant rule declared by this Court: the government *does* assume responsibility for its actions in connection with

federal commercial programs and activities. *Franchise Tax Board v. United States Postal Service,* 467 U.S. 512, 520 (1984); *see also Loeffler v. Frank,* 108 S. Ct. 1965 (1988). Indeed, to require the government to honor its commitments when participating in commercial programs will ultimately promote governmental efficiency and reduce governmental waste.

In *Franchise Tax Board* this Court held that when Congress has "launched" a federal government agency into the "commercial world" by virtue of, *inter alia,* waiving sovereign immunity and permitting the agency to "sue or be sued," there is a presumption that the government agency's liability is the same as that of any other business. 467 U.S. at 520. This rule was followed recently in *Loeffler,* where this Court held that the "sue and be sued" clause must be liberally construed and found that the Postal Service is liable for prejudgment interest under appropriate circumstances, just as any other business. 108 S. Ct. at 1968-70.

In this case, *accountability, not immunity,* is appropriate where Congress "launched" the EDA into the commercial world pursuant to the Trade Act and permitted the Secretary of Commerce to "sue or be sued" under 19 U.S.C. § 2350. If the decision below is allowed to stand, the "be sued" language in 19 U.S.C. § 2350 becomes meaningless. The federal government would always be able to escape liability for financial obligations it undertook with its eyes wide open, with full knowledge and disclosure of the risks, while its officials lead private citizens down a path of false belief that the government is satisfied and will not seek to disavow its obligations. The law does not permit private financial intermediaries to engage in such unfair dealings and sharp practices. Nor did Congress intend for the government to do so.

The manifest unfairness of absolving the government from responsibility here is best illustrated by the Seventh Circuit's attention to Weber's 1981 financial statements. The court of appeals held that closing the loans in the

face of the 1981 financial statement was reason enough to allow the federal government now to disavow its guarantees to Citizens. However, under the terms of the guaranty program, the EDA, and not Citizens, was responsible for determining that the loans would be closed. Furthermore, the government had reviewed Weber's 1981 financial statements, had received the accounting firm's letter of concern before closing and had the opportunity to withdraw its guaranty, but instead chose to have Citizens proceed with the loans. It is wrong now to allow an appellate court to amend the guaranty agreements for the benefit of the federal government and arbitrarily impose the responsibility for closing the loans upon Citizens.[13]

A. The Failure To Resolve The Question of Governmental Responsibility Has Caused the Circuits To Apply Different Standards and To Reach Inconsistent Results.

The court of appeals' decision in this case conflicts with several recent decisions of other courts of appeals. Here the Seventh Circuit declared that all the elements of common-law estoppel must be met, and then, contrary to the district court, announced its own substitute findings that there were no "misleading silences" or "reliance by the bank." A.11. But several circuits have found the government accountable for its actions without specifically relying on the traditional elements of the estoppel doctrine. *See, e.g., Maxima Corp. v. United States,* 847 F.2d 1549, 1556-57, n. 6 (Fed. Cir. 1988) ("The need for mutual fair dealing is no less required in contracts to which the government is a party, than in any other commercial

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[13] Contrary to the court of appeals' suggestion that Citizens "waived" this argument, Citizens expressly argued below that the responsibility for closing Weber's Trade Adjustment Assistance loans was the EDA's, not Citizens'. A.9. Brief of Plaintiff-Appellee at 33-40, *Citizens Marine National Bank v. United States Dept. of Commerce.*

arrangement," and "that the government can always change the bargain, even long after performance of that bargain and whatever the facts, is [an] anathema not only to the rule of law but to the principles of a great commercial nation."); *Brown v. Marsh*, 777 F.2d 8, 16 (D.C. Cir. 1985) ("[T]he Army's conduct . . . more than justifies our refusal to allow it to raise its claim. . . .").

In addition, a confusing plethora of inconsistent and contradictory tests have emerged among the circuits applying equitable estoppel against the government. *See generally* Note, *Equitable Estoppel of the Government*, 79 Colum. L. Rev. 551 (1979). For example, the Ninth Circuit has developed an "affirmative misconduct" requirement. *Wagner v. Director, Federal Emergency Management Agency*, 847 F.2d 515 (9th Cir. 1988). The Fifth, Sixth, Ninth, Tenth and Eleventh Circuits, together with the Court of Claims, have at times applied a proprietary/sovereign distinction depending on which role the government's actions more closely resemble. *See, e.g., Federal Deposit Insurance Corp. v. Harrison*. 735 F.2d 408, 412 (11th Cir. 1984) (The "FDIC should be required to deal fairly with its debtors and should be held accountable for the representations of its agents"); *United States v. Mattucci*, 502 F.2d 883 (6th Cir. 1974); *New Mexico v. Aamodt*, 537 F.2d 1102 (10th Cir. 1976), *cert. denied* , 429 U.S. 1121 (1977); *United States v. Florida*, 482 F.2d 205 (5th Cir. 1973); *Branch Banking & Trust Co. v. United States*, 98 F. Supp. 757 (Ct.Cl. 1951), *cert. denied*, 342 U.S. 893 (1951). *See also United States v. Georgia-Pacific Co.*, 421 F.2d 92, 100, 103 (9th Cir. 1970) ("[I]t is hardly in the public's interest for the Government to deal dishonestly or in an unconscientious manner. This is especially imperative in a time when few individuals and corporations, if any, can escape numerous dealings with the Government and its agents." . . . "The claim of the government to an immunity from estoppel is in fact a claim to exemption from the requirements of morals and justice."); Berger, *Estoppel Against the Government*, 21 U. Chi. L. Rev. 680 (1954).

The lack of guidance concerning the standards for governmental responsibility has allowed lower courts to fashion different standards and devise contradictory, result-oriented decisions. The facts of this case warrant this Court's consideration of the governmental responsibility issues in order to clarify the law and provide the appropriate guidance to the lower courts.

B. Fundamental Principles of Guaranty Law Apply to the Government in This Commerical Transaction.

This Court recognized in *Lyng v. Payne,* 476 U.S. 926, 936 (1986), that the existence of "estoppel-like" considerations and "estoppel-like" effects resulting from the proper application of other distinct legal principles, does not require satisfaction of all the elements of common-law estoppel in order to decide a case. ("We reject [the] . . . suggestion that any remedy that can be analogized to an equitable estoppel is necessarily invalid, regardless of the source of the cause of action, unless the plaintiff succeeds in proving all the elements of common-law estoppel"). *See also Brown v. Marsh,* 777 F.2d at 16. Because the governmental responsibility issue here is resolvable in the context of appropriate principles of guaranty law, it is not necessary for Citizens to show all the elements of common law estoppel. Even if Citizens was required to do so, however, all of the elements of estoppel are present here. *See* Section II., *infra* at p. 23.

The EDA officials did much more than merely "turn a blind eye" or "wink" at Citizens as the court of appeals suggests;[14] the EDA controlled the course of the loan. The

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[14] When presented with completely private commercial situations the Seventh Circuit, and the author of its opinion here, certainly adhere to general principles of guaranty law and recognize the significance of the guarantor's knowledge; a guarantor may not escape liability because of increased risk *if he knows* of the risk and proceeds heedless of it. *United States Shoe Corp. v. Hackett,* 793 F.2d 161, 163 (7th Cir. 1986).

record is clear that Citizens informed the government of its actions as they occurred and provided all information the government requested.[15] The government did not object to the actions taken by Citizens or demand alternative courses of action. Though the court of appeals begrudgingly acknowledged these facts, it erroneously deemed them of no consequence merely because federal officials were involved. Certiorari should be granted to resolve the important question of whether the government's participation in commercial transactions pursuant to government credit programs *is of consequence* to the rights of private parties.

II. THE COURT OF APPEALS ENGAGED IN UNAUTHORIZED FACT-FINDING IN DIRECT CONFLICT WITH THIS COURT'S DECISON IN *ICICLE SEAFOODS, INC. V. WORTHINGTON.*

The court of appeals openly engaged in the very appellate fact-finding expressly condemned by this Court in *Icicle Seafoods, Inc. v. Worthington,* 475 U.S. 709, 714 (1986). To reach its result it found that the EDA had not misled Citizens even by silence, and that Citizens had not relied. A.11. It is bad enough for the court of appeals to throw out a district court's findings of fact for no apparent reason other than disagreement — it is quite another, and beyond the appellate power, for the court of appeals to substitute its own factual determinations. Such unauthorized appellate fact-finding presents reason enough for this

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[15] For example, the district court found that the EDA condoned Citizens' disbursement practices and was therefore precluded from *contending* that Citizens' procedure was unreasonable and imprudent. Furthermore, the procedures followed by Cititzens for the disbursement of loan funds were given prior approval by the government. R. 228.

Court to grant this petition and summarily reverse the court of appeals.[16]

The record showed without dispute that the government represented to Citizens its willingness to accept the credit risk for Trade Adjustment Assistance loans to Weber, and that Citizens otherwise would not have lent the money. That was the very purpose of the entire Trade Adjustment Assistance guaranty program: to induce lenders like Citizens to make loans they would not otherwise make. And the record without dispute, on stipulated facts, showed that the EDA was involved in and set requirements, which were observed, for every step of the transaction. A.21-60.

Yet the appellate panel found that "there were no promises, misrepresentations, or misleading silences, and there was no reliance by the bank." A.11. The court of appeals' determination of these facts may very well be consistent with a free market economic philosophy hostile to such government programs, but it is simply not supported by Congressional intent,[17] the reality of this government program, and most importantly the record.

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[16] There is also absolutely no record support for the appellate finding that Citizens was "tempted" to improve its position by way of the government guaranty program. A.8. Pursuant to its own guidelines, and prior to closing the loan, the EDA had performed a specific analysis and determined that Citizens was more, or equally, exposed after the loan guarantees as compared to before. Ex. 37; R. 188. Furthermore, Citizens was required to subordinate to EDA its position regarding Weber's debt prior to Weber's application for Trade Adjustment Assistance. The only explanation for the panel's view is unfounded speculation, which pervades its entire consideration of the record.

[17] The court of appeals also misconstrued and misapplied the "reasonable assurance of repayment" requirement. It stated:

> The Trade Act of 1974 authorizes the government to make risky loans (or loan guarantees)—indeed, *requires* that they be risky, since a condition precedent

Continued

The court of appeals' unsupported conclusion that the EDA officials "who exercised inadequate oversight in this matter [did not have] any actual or apparent authority" is not only incorrect, but merely begs the central question of governmental responsibility. The situation here is far more compelling than that presented to this Court in the *Heckler v. Community Health Services* case, 467 U.S. 51, where a non-government party was acting as a governmental "agent" under the Medicare program. Here, the EDA officials acted with both actual and apparent authority through formal delegation in accordance with federal law. A.30-32, 35-43, 82; Ex.7.

Because the court of appeals stepped well beyond what this Court found to be inappropriate fact-finding in *Icicle,* review of this case is necessary.

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[17] *Continued from previous page*

> is that the borrower be unable to obtain financing on ordinary terms in the private capital markets. But the Act also requires that there be at least a reasonable assurance of payment, and this requirement was implemented by the altogether sensible provision in the guaranty agreement requiring the bank to act with the prudence of a normal commerical bank that had made a loan not guaranteed by the federal government.

A.10-11. However, the reasonable assurance of repayment requirement must be satisfied *by the EDA after* the EDA's certification and *prior* to the EDA's approval of Trade Adjustment Assistance. *See* 19 U.S.C. §2345(a)(2); A.52. To suggest that the "reasonable and prudent commercial bank" provision of the guaranty agreement, which clearly only applied to post closing actions by Citizens, somehow "implements" the "reasonable assurance of repayment" requirement under the Act, evidences the tortured analysis used by the court of appeals to reach its result.

III. THE COURT OF APPEALS' PENDENT JURISDICTION RULING IS IN DIRECT CONFLICT WITH DECISIONS OF THIS COURT.

Certiorari should be granted also to review the court of appeals' pendent-jurisdiction ruling regarding Citizens' claim against the Hutchinsons on their guaranty because: (1) it involves the same important interests and policies recognized by this Court's recent grant of certiorari in *Finley v. United States, cert. granted,* No. 87-1973; (2) it is directly contrary to the principles and standards of pendent jurisdiction declared by this Court; (3) it abrogates the intent of Congress regarding the EDA program; and (4) it is grounded in a philosophical view of federal jurisdication not supported in the law and is reached only by a selective review of the record.

In *Finley,* the plaintiff brought claims against the United States properly invoking the jurisdiction of the federal district court. The plaintiff then moved to amend her complaint to add claims against third parties for which no independent basis for federal jurisdiction existed. The district court held that since the litigation arose from a common nucleus of operative fact, judicial economy, efficiency and fairness mandated that the case be resolved in one forum. Prior to a determination on the merits of the claims, the pendent jurisdiction issue was certified to the Ninth Circuit, which reversed the district court.

Even more significant circumstances and considerations of judicial economy, efficiency and fairness are presented in this case. Here, Citizens asserted claims against the governmental defendants and properly invoked the jurisdiction of the district court. Citizens also asserted claims against third parties, the Hutchinsons. But, in addition, the Hutchinsons asserted a claim against the government relating to the EDA's interest in the

collateral arising out of the guaranty loan transactions.[18] The district court not only exercised jurisdiction over all these related claims, but, unlike *Finley*, proceeded to address and determine the merits of those claims. A.61, 70. Thus, the appellate panel's decision vacating Citizens' judgment against the Hutchinsons accomplishes only what the pendent jurisdiction doctrine is intended to avoid: duplicative litigation and judicial inefficiency and waste. *See Carnegie-Mellon University v. Cohill,* 108 S. Ct. 614, 618 (1988); *United Mine Workers of America v. Gibbs,* 383 U.S. 715, 726 (1966). Moreover, instead of applying "the common nucleus of operative fact" standard, the Seventh Circuit here required identity of "the facts upon which the determination of liability . . . [is] based." A.7.

In *Cohill,* this Court found, just last Term, that multiple federal and state claims, as divergent as a violation of federal age-discrimination law and a state defamation claim, arose from a "common nucleus of operative fact": the dismissal of an employee. 108 S.Ct. at 619. As in *Cohill,* Citizens' claim against the EDA and Citizens' claim against the Hutchinsons on their guaranty arise from a "common nucleus of operative fact": Weber's default on the loans. The EDA guaranty, pursuant to the EDA program, required the Hutchinsons' guaranty as a necessary element of the Weber Trade Adjustment loan. In fact, the Hutchinsons' guaranty was a required item of collateral in which the EDA itself obtained an interest. Exs. 2-6, 10-13, 50, 76, 77.

The court of appeals improperly stripped the district court of its broad discretion to hear Citizen's claim against the Hutchinsons, only to send the same parties off to relitigate the same claim in a different forum. It also

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[18] The district court granted summary judgment against the Hutchinsons on this claim. However, the court of appeals never considered the effect of the assertion of the Hutchinsons' claim against the government on the pendent jurisdiction issue between Citizens and the Hutchinsons.

undermined the Congressional determination to provide a federal forum for parties involved in transactions arising under the EDA loan program. Certiorari is necessary to clarify the scope and application of the pendent-party jurisdiction doctrine and to correct the Seventh Circuit's unjustified restriction of pendent jurisdiction in this case.

CONCLUSION

For the reasons stated, certiorari should be granted.

Respectfully submitted,

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